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This is the sixteenth of a series of occasional papers to be published from time to time by the Group of Thirty. These papers are prepared for the use of the Group as part of its general study of the international economic and monetary system, but publication does not imply endorsement by the Group of any of the views expressed herein.

R5025-3

Occasional Papers
No. 16

Policy Lessons of the Development Experience

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Published by
Group of Thirty©
New York
1985

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Printed in the United States of America.

Library of Congress Cataloging in Publication Data

Hughes, Helen.
Policy lessons of the developemnt experience.

(Occasional paper; no. 16)
Bibliography: p.
1. Economic developmnt. I. Title. II. Series Occasional Paper (Australian National University. Development Studies Centre ; no.16(
HD83.H786 1985 338.9 85-7989

Policy lessons of the development experience

It is now well established that the world has experienced unexpectedly and unprecedentedly high growth since World War II.[1] Before the industrial revolution in the 18th century national income grew imperceptibly, and even in the 19th century and up to World War II per capita growth rates of more than 2 per cent per annum were exceptional and rarely sustained for any length of time.[2] In the 1950s and 1960s standards of living improved rapidly in Northern American, Western European and other high income countries, with some countries catching up to, and some even surpassing, United States productivity and income levels. Japan, which had begun to industrialize at the end of the 19th century (as had Russia and some countries of Central and Eastern Europe), was the last and most spectacular participant in this 'catching up' process. Many of the countries emerging from colonial and neo-colonial dependence also began to make remarkable progress as they achieved independence. Some compressed the development that had taken industrial countries 100 years and more to achieve into 30 years or so. The liberalization of trade, capital and labor flows stimulated national economic performance by enabling countries to specialize and take advantage of economies of scale, transfers of technology and increased competitiveness. Despite difficulties, growth continued to be high during the 1970s by historical standards, particularly in those developing countries with strong impetus to catch up the industrial countries.

The initial impact of growth in developing countries, together with worldwide health measures, increased population growth. As a result, per capita income grew only slowly for developing countries as a group, masking the very rapid progress that some were achieving. However, in the 1970s, when the growth of the industrial countries began to lag (largely

because of social rigidities resulting from the very success of full employment and rapid income increases of the 1950 and 1960s), the rapid growth of some of the developing countries became striking, in part because increasing productivity made them competitive with the established industrial countries at the margin. As incomes grew, a demographic transition from high death and fertility rates to longer life expectancy, lower fertility and slower population growth began to take place. The rapidly growing developing countries began to catch up with the industrial contries in per capita income terms[3], though others, which were not following growth oriented policies, continued to fall behind.

By the early 1980s it had become evident that the world does not consist of a 'north' and 'south', but that it is a continuum ranging from very poor countries such as those in the Sahel to very high income countries such as Saudi Arabia and Switzerland. It includes rapidly growing developing countries that are beginning to overtake 'old' Southern European countries, such lagging industrial countries as Ireland, and the centrally planned economies of Eastern Europe. Moreover, although all countries face the same international conditions, their places in the continuum shift as some accelerate their growth while others are left behind.

An overview of development

Four developing economies of East and Southeast Asia — Hong Kong, the Republic of Korea, Taiwan and Singapore — have together with Japan had the world's fastest national product growth since the 1950s. Three other members of the Association of South East Asian Nations — Indonesia, Malaysia and Thailand — were the second fastest growth group (Table 1). These countries' performance was not uniform: Japan's growth rate peaked in the 1960s; Hong Kong 'took off' in the 1950s and has achieved sustained and rapid growth ever since; Taiwan changed its policies to follow a growth path from the late 1950s; Korea, Singapore and Thailand began to grow rapidly in the mid 1960s, Malaysia in the early 1970s, and Indonesia only in the second half of the 1970s. Other Southeast Asian countries have not performed so well. The Philippines followed a patchy, 'stop-go' path that was akin to the experience of Latin American countries. Burma, Vietnam, Laos and Cambodia have had little or no growth and even drastic declines in standards of living (The lagging countries depress the performance indicators for East and Southeast Asia in Tables 1 and 2 and those following).

Only a handful of countries in other regions have achieved growth rates as high as those of the high growth East and Southeast Asian

economies, mostly for relatively short periods. They were mainly in Southern Europe which, with its close ties to Western Europe, grew rapidly in the 1950s and 1960s but was unable to maintain high growth rates of more than 7 per cent per annum through the late 1970s and early 1980s.

In Latin America and the Caribbean, growth slowed in the 1970s despite the expanding markets for labor, goods and services, and the availability of low cost capital as a result of a great increase in savings by petroleum producers. The 1981-82 recession precipitated a 'stop' phase in many Latin American countries, resulting in low growth and even in falling incomes.

The sub-Saharan African countries had grown more slowly than most other regions in the 1960s, and in the 1970s their growth declined sharply. There were exceptions (including Botswana, the Ivory Coast, Kenya, Lesotho, and Malawi). But in most sub-Saharan African countries the lack of human resource development made it difficult to escape the 'vicious circle of poverty'. With slow development even in countries with rich natural resource endowments, the living standards achieved by the end of the 1960s could not be maintained in the 1970s in the face of rapid population growth.

The South Asian countries began the 1970s badly, with the Pakistan-Bangladesh war and poor monsoons, but made remarkable progress towards the end of the decade. Improved agricultural output was the critical factor, particularly in India, which became self-sufficient in grains by the end of the decade. Declining food imports reflected the success of agricultural policies. Exports continued to grow slowly, but workers' remittances from the Middle East greatly eased balance-of-payments problems. Inadequate data make it impossible to assess growth trends in China, but by the 1970s extremes of poverty had been eradicated and a low level 'basic needs' living standard was widely established.

Paradoxically, petroleum-importing countries grew more rapidly than petroleum-exporting ones in the 1970s. For most petroleum exporters, growth rates peaked in the 1960s (albeit from low levels), when petroleum prices were still low, because petroleum output and exports were rising rapidly enough to boost economies, though not so rapidly as to lead to serious 'Dutch Disease' difficulties.[4]

The developing countries were all affected by the 1981-82 recession in the industrial countries. The demand for primary products fell, the growth of markets for manufacturers and services slowed, and a shift from low (and even negative) real interest rates to historically very high ones raised the cost of servicing debt. GDP growth in many developing countries became sluggish, dropping overall to about 2.5 per cent in 1981-82. Some

TABLE 1
GDP Growth by Region, 1960-1983

Country group	GDP, 1980 (US$ billion)	Average annual real growth rate				
		1960-73	1973-80	1981	1982	1983
		percent				
Low income countries	546	5.7	4.9	4.0	5.0	7.2
Asia	493	6.0	5.2	4.3	5.4	7.8
China	284	8.5	5.8	2.9	7.4	9.0
India	162	3.6	4.1	5.8	2.6	6.5
Africa, South of Sahara	53	3.7	2.7	1.7	0.7	0.7
Middle income countries	1,668	6.5	5.3	2.3	1.4	1.1
East Asia & Pacific	310	7.3	7.9	6.9	3.6	5.8
Middle East & North Africa	239	7.6	4.3	−1.1	7.1	9.7
Africa, South of Sahara[a]	123	5.7	3.6	−0.9	−1.9	−3.3
Southern Europe	213	6.7	4.8	2.0	2.4	0.8
Latin America & Caribbean	703	6.1	5.4	1.7	−0.9	−2.9
Middle income oil importers	978	6.3	5.6	2.0	0.8	0.7
Middle income oil exporters	690	6.8	5.0	2.6	2.2	1.6
All low & middle income developing countries	**2,214**	**6.3**	**5.2**	**2.7**	**2.3**	**2.6**
High income oil exporters	230	10.6	7.7	0.1	−1.7	−7.0
Industrial countries	7,440	4.9	2.8	1.4	−0.3	2.2

[a] Excludes South Africa, which, however, is included in sub-totals and totals. The total income of this group of countries is dominated by that of Nigeria (with about 60 percent of the region's income).

Source: World Bank, *World Tables: The Third Edition* (Baltimore and London: published for the World Bank by the Johns Hopkins University Press, 1983) data base. For country composition used here and throughout this paper, see World Bank, *World Development Report, 1984* (Washington, D.C., 1984).

countries slipped back. Growth rates were halved in East and Southeast Asia, but not until 1982 when growth fell to somewhat less than 4 per cent. But this was much higher than the developing and industrial country average.

The range of growth rates is even greater when per capita income is used as the indicator of growth, as rising living standards, through a decline in fertility rates, are usually the most important factor in declining population growth. Because of the rapid growth of total income, the reduction of extreme poverty, and the consequent decline in population growth, the leading East and Southeast Asian countries had a per capita GDP growth above that of most other developing countries in the 1960s; by the 1970s and early 1980s their per capita growth far surpassed that of all other developing country groups (Table 2).

The measurement of poverty alleviation and the attainment of greater equity in income distribution is so difficult that cross-country comparisons must be treated with the utmost caution. With this proviso, such income distribution data as seem reasonably reliable and comparable suggest that the fastest growing countries are also those with the most equitable income distribution. Physical social welfare indicators such as infant mortality rates (a proxy for nutrition, availability of health services, etc.) and life expectancy at birth (a proxy for overall living standards) also suggest that the rapidly growing countries have also achieved the greatest poverty alleviation,[5] particularly if poverty alleviation is an important component of growth objectives. Poverty alleviation did not, however, result from asset or income redistribution but from policies that provided rapid improvement in access to productive income earning activities. Thus, physical indicators for Hong Kong and Singapore are in the industrial country range, and these city states also did remarkably well in providing mass access to education, health facilities and housing.

These results are not surprising. Only countries that grow rapidly have the means to redistribute incomes. Countries such as Sri Lanka that had fairly favorable social conditions at the end of the colonial period have been able to do little to improve them because they only grew slowly. Countries that had policies heavily skewed toward equity without due attention to growth, such as Tanzania or Jamaica, achieved neither. Rapid and sustained growth is clearly necessary for poverty alleviation and greater equality of opportunity.

TABLE 2
Growth of GDP per Capita by Region, 1960-83

Country group	Population 1980 (million)	GDP per capita, 1980 (US$)	Average annual real growth rate of GDP per capita				
			1960-73	1973-80	1981	1982	1983
			percent				
Low income countries	2,098	260	3.2	3.0	2.1	2.9	5.1
Asia	1,901	260	3.6	3.4	2.6	3.4	5.9
China	980	290	6.1	4.5	1.6	5.7	7.6
India	687	240	1.3	1.8	3.6	0.4	4.1
Africa, South of Sahara	197	270	1.2	0.0	−1.5	−2.3	− 2.3
Middle income countries	1,073	1,550	3.9	2.8	−0.0	−1.0	− 1.3
East Asia & Pacific	322	960	4.7	5.5	4.7	1.5	3.6
Middle East & North Africa	159	1,500	4.7	1.4	−3.9	4.1	6.6
Africa, South of Sahara[a]	129	900	2.9	0.8	−4.3	−5.2	− 6.6
Southern Europe	91	2,340	5.0	3.1	0.5	0.7	− 0.8
Latin America & Caribbean	344	2,040	3.3	2.9	−0.6	−3.2	− 5.1
Middle income oil importers	579	1,690	3.8	3.3	−0.0	−1.4	− 1.5
Middle income oil exporters	494	1,400	4.1	2.2	−0.1	−0.5	− 1.1
All low & middle income developing countries	**3,171**	**700**	**3.8**	**3.1**	**0.7**	**0.1**	**0.4**
High income oil exporters	16	14,090	6.1	2.3	−4.3	−5.9	−11.0
Industrial countries	714	10,420	3.9	2.1	0.7	−0.9	1.6

[a] Excludes South Africa, which, however, is included in sub-totals and totals. The total income of this group of countries is dominated by that of Nigeria (with about 60 percent of the region's income).

Source: World Bank, *World Tables: The Third Edition* (Baltimore and London: published for the World Bank by the Johns Hopkins University Press, 1983) data base.

Paradigms of economic growth

Three principal schools of thought have dominated explanations of economic development. The foremost has been the 'dependencia' view of development that saw the problems of developing countries largely in terms of international economic relations. It was argued that the international economic system was skewed against developing countries because the elasticity of supply of primary commodities produced by the developing countries was greater than the elasticity of demand for those goods. The reverse was true for industrial goods which the industrial countries exported and the developing countries imported. The 'dependencia' school flourished strongly in Latin America and the Caribbean immediately after World War II. It was also argued that developing countries could not compete against industrial countries in the production of manufactured goods, and that accordingly they should adopt strongly protectionist industrialization policies to overcome this disability. The transnational corporations were thought to represent the interests of the industrial countries, extorting monopoly profits through trade marks and patents, and refusing to transfer new technology to developing countries. Public control of key sectors of the economy was thought to be necessary to overcome the ensuing politico-economic obstacles to development.

In the late 1950s, however, growth faltered in the countries that had followed highly protectionist 'inward oriented' policies, with a consequent neglect of agriculture. Employment grew slowly, balance-of-payments difficulties emerged and ultimately growth halted altogether, with consequent economic and political upheavals. Instead of leading to the questioning of protectionist prescriptions, an extension of protectionist views led to proposals for regional integration which was to offset the smallness of the markets of individual developing countries. The formation of the Central American Common Market, of the Latin American Free Trade Area and of the Caribbean Free Trade Area followed. Raoul Prebisch was the key figure in the development of the economics of 'dependencia', strongly influencing at least a generation of economists and policy-makers in Latin America.[6] His ideas spread through the international bureaucracy, firstly in the Economic Commission for Latin America, which played a very important role in Latin American policy formulation in the 1950s and 1960s, and then throuh the United Nations headquarters in New York. Here Latin American influences melded with those from South Asia where similar approaches to development had become entrenched.[7] Following the interwar industrialization experience and World War II success of the USSR, South Asian views leaned strongly towards compehensive national

TABLE 3

Gross Domestic Savings and Investment as Shares of GDP by Region, 1960-82

Country group	Gross domestic savings as a share of GDP				Gross domestic investment as a share of GDP			
	1960	1970	1980	1982	1960	1970	1980	1982
Low income countries	20	23	23	22	21	24	27	25
Asia	21	23	25	24	22	24	28	26
China	28	30	30	30	28	30	31	28
India	14	18	21	22	17	18	25	25
Africa, South of Sahara	12	16	10	6	14	17	19	16
Middle income countries	19	21	26	22	20	23	27	26
East Asia & Pacific	13	19	28	24	15	23	29	27
Middle East & North Africa	18	20	30	24	20	19	31	34
Africa, South of Sahara[a]	16	21	28	17	19	20	25	25
Southern Europe	21	20	21	21	25	27	29	27
Latin America & Caribbean	21	22	23	22	20	23	24	21
Middle income oil importers	19	21	23	21	21	24	27	23
Middle income oil exporters	21	21	30	24	19	21	27	28
All low & middle income developing countries	**19**	**22**	**25**	**22**	**21**	**23**	**27**	**25**
High income oil exporters	47	48	57	48	16	15	22	24
Industrial countries	22	23	22	20	21	23	23	20

[a] Excludes South Africa, which, however, is included in sub-totals and totals.

Source: World Bank, *World Tables: The Third Edition* (Baltimore and London: published for the World Bank by the Johns Hopkins University Press, 1983) data base.

planning to replace market forces and to prevent the emergence of domestic centers of monopoly and political power. More attention was paid to egalitarian issues than in Latin America.

Most African and Middle Eastern countries were comfortable in this intellectual environment which blamed neo-colonialists rather than their own policies and management for economic failure. A new 'development economics'[8] justifying the failure of many developing countries to adopt growth-oriented policies became established, notably in development institutions in industrial countries, thriving on meetings and conferences organized by United Nations and other international organizations. 'Development economics' came to dominate the Asian and African regional economic and social commissions as they, too, expanded in size. Developing countries lobbied successfully for the establishment of the United Nations Conference on Trade and Development and of the United Nations Industrial Development Organization to foster the 'dependencia' schools of thought.

But the countries that adopted the 'dependencia' viewpoint in their domestic policies continued to be plagued by economic difficulties despite the high prosperity that ruled global markets until the end of the international commodity boom in 1974. As primary products reached record prices, and particularly after the petroleum price increases of 1973-74, the 'dependencia' forces through the 'Group of 77' developing countries sought to turn a temporary gain in the barter terms of trade into a permanent feature of the international economy. Some of the petroleum-rich Middle Eastern countries now took the lead. The ensuing pursuit of a 'new international economic order' was intended to substitute international planning and management for international goods and capital (and in some cases labor) markets. The cornerstones of this policy — the General Scheme of Preferences for exports of manufacturers from developing countries, the Common Fund, taxes on 'brain drain', sea resources, arms expenditures and even trade, larger and more automatic transfers of aid through a Special Drawing Rights 'link', access to private capital markets without the creation of debt, and the replacement of the economic by a political base in the International Monetary Fund and World Bank to ensure that such policies would be implemented — all these were summarized in the Brandt Report in 1980 when this movement reached its peak.[9]

A second, more technical approach to the analysis of development was represented by a 'structural' school of thought. Starting with Rosenstein-Rodan's work on the reasons for the lagging development of Balkan countries,[10] this school also owes much to Rostow's 'stages of growth',[11] Kuznets' historical work,[12] and to Hirschman's theories of

'backward and forward' linkages in economic activity and to his 'balanced' and 'unbalanced' growth dichotomies.[13] 'Structural' theories saw development as a series of steps: from predominantly agricultural to predominantly industrial activities; from low labor productivity to high labor productivity; from low savings to high savings; from low and simple to high and diversified exports. Input-output tables came to play a key role in analysis, but their fixed coefficients made for elasticity pessimism and hence grossly underestimated the potential for change. Chenery opened hitherto inward- looking structural models through the 'two gap' theory of the need for capital inflows to meet savings and balance-of-payments constraints.[14] Aid and other capital flows came to play an important role in development discussions, often exaggerating the role of aid donors and other external capital flows in national growth.

To understand the patterns of structural change, countries were classified by their size, location, resource endowment, and similar natural characteristics. Such characteristics as the level of per capita income, the share of agriculture in total output, the 'structure' of manufacturing by end use (consumer, semi-processed and capital goods) were regarded as important indicators of development.[15] General equilibrium modelling of increasing complexity sought to indicate how economies 'tracked' through a series of development phases. In the 1970s, income distribution was added to previously production-oriented characteristics. 'Levels of development' were identified with Gini coefficients.[16]

The 'dependencia' and 'structural' schools of thought had much in common. Structural characteristics such as 'landlocked', 'sealocked', 'least' developed, 'most affected' (by petroleum price increases), 'primary product exporting' and 'exporting manufactures' found their way into everyday parlance to indicate the extent to which countries were disadvantaged by international conditions. 'Linkages' became an argument for protection (and regional integration). Planning the steps to development for greater efficiency fitted the views of the 'dependencia' and input-output schools, and resources were accordingly devoted to detailed 5, 7 and 10 year plans. Growth targets were linked to other capital availabilities and the demand for goods produced by developing countries. Elaborate sector programming underpinned the programming of national and international growth. Calculations were made to indicate whether a country was reaching appropriate structural characteristics by reference to its natural endowment and per capita income peer group.

The third approach to economic development applied standard economic concepts and tools of analysis to development situations with a view to formulating policies that would enable a country to exploit its

strengths and minimize its weaknesses to attain rapid growth. This 'economics of development' approach was concerned with the analysis of the behavioral characteristics of such economic units as farmers, workers and consumers. Propensities to consume, to save and to invest were perceived to be the key to growth because they could be influenced by policies relying on market mechanisms which, if well informed and competitive, could lead to the efficient allocation and utilization of resources nationally and through international economic relations. The role of national governments and international agreements was, first, to introduce 'rules of the game' to enable markets to operate competitively and, secondly, to provide 'public goods' efficiently and equitably.

The growth experience

The theoretical insights of the 'economics of development' were borne out in practice. Israel turned to export-oriented policies to break the 'vicious circle of poverty' and to turn it into a 'virtuous circle' of growth through participation in international markets in the 1950s. Hong Kong went further, following an export-oriented strategy in a very liberal domestic policy environment. The successful encouragement of Puerto Rican exports to the United States to exploit tariff preferences was subsequently translated in Taiwan and in Korea to production for export to the opening industrial country markets. In Israel and Taiwan agricultural exports were key to turning the economies outward. In Korea, though the agricultural sector was not neglected, manufactured exports led the way as they had in Hong Kong. Export-oriented policies meant attention to appropriate exchange rates and this meant that not only trade, but financial and fiscal policies had to be 'right' to avoid major distortions in wage, exchange, interest rates and other key prices. Other distortions had to be offset by incentives in agriculture, industry and other sectors. Government investment in social and physical infrastructure was also a key factor in growth. Very large flows of aid facilitated the policy changes required to set Israel, Taiwan and Korea on a growth path. But Singapore, like Hong Kong, followed an export-oriented strategy from 1965 (after it left the rather inward-turning Malaysian Federation), on its own initiative and with its own resources.

A number of economists, including several from developing countries, used standard economic tools to analyze development trends. Some, such as Lewis[17] and Myint[18] were from developing countries. Ishikawa[19] came from Japan which was still climbing the development ladder. Economic data began to be gathered and the International Monetary Fund and World Bank reports and supporting data provided a

basis for applied analysis. Many economists from industrial countries became interested in the analysis of development trends as aid agencies began to program aid strategies. The growth of tertiary education and research organizations stimulated economic research in the developing countries.

In the early 1970s, Little, Scitovsky and Scott,[20] and Johnson,[21] made seminal contributions to the understanding of the societies that 'dependencia' and 'structuralism' had built. The developing countries that had followed basically protectionist and 'inward-looking' economic strategies, and that had managed their exchange, monetary and fiscal policies in accordance with 'dependencia' principles, were growing slowly. Some attempted to offset protection biases by introducing export incentives. But without a reduction of protection and the reform of financial and fiscal policies they distorted their economies further, often to the point at which real resource costs were totaly obscured. Protectionist industrialization policies continued to skew the economy against agricultural development, often leading to low agricultural productivity and output. Excessive capital intensity with concomitantly slow employment growth characterized manufacturing.[22] Balance-of-payments problems were endemic. Resource-rich countries suffered severe bouts of the 'Dutch Disease'. Loose financial and fiscal policies relied on inflation as the principal source of taxation, exacerbating economic management difficulties by undermining the propensity to save and invest. As these man-made problems of development came to a head, boom gave way to crisis, increasing the underlying problems of the economy for which (politically) easy policies sought quick fixes. The international impact of petroleum price rises, the ability to borrow in highly liquid capital markets, and the industrial countries' weak policies, increased the amplitude of the 'go' policy swing in the 1970s leading to an unusually deep 'stop' swing in the early 1980s when the industrial countries' inability to manage their economies without a recession began to be felt through sluggish export markets and high interest rates.

The International Monetary Fund came to play a key role in the 'dependencia' mythology. When all domestic resources and international credit became exhausted so that very onerous measures became necessary to avoid economic collapse, the International Monetary Fund was called so that national responsibility for past mismanagement and future hardships from a country's government could be avoided. Well-managed and rapidly growing countries also used Fund facilities, but did so to ease difficult conditions arising from domestic problems such as poor harvests or fluctuations in the world economy, approaching the Fund before a crisis

threatened, and generally having few differences in the analysis of what had to be done to improve the situation.[23]

The leading East and Southeast Asian, and other well-managed countries, showed that high rates of growth could be sustained through the 1970s. For example, Singapore had moved from mediocre performance to rapid growth in the second half of the 1960s when it adopted internationally competitive policies. Unemployment fell from an estimated 13 per cent to zero. A labor shortage developed by the early 1970s and high economic performance has been maintained since. Rapidly-rising real wages indicated a similar situation in Hong Kong despite continuing immigration. By the 1980s, both Singapore and Hong Kong were recruiting workers abroad to overcome labor shortages. The Taiwanese and Korean economies were transformed in the 1960s by policy changes that encouraged the growth of output and productivity in all sectors, stimulated exports and hence provided an ample import capacity.

Thailand and Malaysia grew strongly from the mid-1960s with agricultural development leading in production and exports until the 1970s. Some countries also did well in other regions by following policies that led to an efficient allocation and utilization of resources. Spain graduated to being a 'developed' country. Malta grew rapidly. Mauritius performed well. Jordan began to stand out in the Middle East. Barbados became a relatively strong performer in the Caribbean. Colombia had a steadier and stronger growth path than other Latin American countries. The analytical perceptions of such analysts as Krueger[24] and Balassa[25] were confirmed in practice as the most export-oriented economies suffered least setbacks in the recession of the early 1980s; the costs of fluctuations were more than offset by the flexibility and entrepreneurship engendered by a competitive environment.

Growth experience suggests that in very broad terms there is a 'Rostowian' pattern in economic development. Developing countries are initially caught in a 'vicious circle of poverty'. They lack the human resources to formulate and implement appropriate economic policies. Once these problems are mitigated, they move into a 'take-off' period during which they use the existing 'shelf' of technology to catch up rapidly to higher income countries. When they do catch up to high income levels, their growth may be expected to decline as they move asymptotically toward 'leading' country levels of productivity and living standards. When all countries are plotted on a per capita income/growth chart, this makes for a 'hat' shaped development pattern.[26] But this pattern is not inherent. It results from policy choices. Thus some countries take a long time to arrive at 'take-off', some are going through the growth process very slowly, even

falling back at times; some, however, are developing quickly, achieving very high growth rates for two, three decades and longer after 'take-off'. Per capita income growth is clearly not simply or even largely a function of per capita income.

Some poor indicators of growth capacity

'Structural' characteristics, such as natural resource endowment, population size and density, and location affect growth but often paradoxically. For example, small countries are often better able to organize politically and socially for growth and thus may grow faster than large countries despite the latter's advantage of economies of scale.[27] A diversity of conditions and interests is difficult to handle. Poorly endowed countries often find it easier to achieve high growth rates than well endowed ones because of the social impact of the lack of resources on economic behaviour. Characteristics of the productive structure, such as the share of industry in GDP at successive levels of income, are analytically meaningless; they merely indicate the common effects of similar economic policies. The inward-oriented import substitution policies prevailing in developing countries in the 1950s and 1960s led to excessively capital-intensive industrial development and undue industrial diversification. The high costs involved in these distortions of resource allocation and utilization gave a relatively high weight to industry in relation to agriculture and other sectors,[28] exaggerating overall growth rates as prices of new manufactured products rose behind tariff barriers.

Cultural characteristics are also poor indicators of growth capacity. Until the 1960s, Korea was regarded as an economic 'basket case' because it was thought to be too concerned with Confucian and Buddhist spiritual issues to consider business activities and economic growth important. Its population was perceived as insufficiently business oriented! Similar judgments have been made about China. The cultural characteristics of Hinduism are still widely, and erroneously, regarded as the cause of India's economic growth difficulties. Migrant groups do seem to stimulate growth through vigorous entrepreneurship, but East Asian 'racial' characteristics do not explain the poor performance of Korea and Taiwan before they changed their economic policies in the 1950s and 1960s; nor do they explain the good performance of such non-East Asian countries as Malta and Jordan.

Differences in political structures also do not explain differences in roles of economic growth. Some democratic and some autocratic countries are development oriented. But many are not.[29] Apparently growth can be fostered by either a democracy or an autocracy. This does

not mean, of course, that democratic forms of government are not inherently much preferable to autocratic ones. In economic terminology, democracy is an important consumption and investment good with a high shadow price, but unfortunately political development is an even more difficult process than economic development.

Several of the rapidly growing countries had a very poor natural endowment and hence few development alternatives, but such countries as Malaysia, for example, were well endowed with natural resources. Some of the rapid growers had an acutely repressive and exploitative colonial history, but others did not. Some were very poor, but others were already at relatively high standards of living in the 1950s. The successful example of Japan was undoubtedly a factor in the East Asian region's policy choices, but the East Asian countries have not followed the Japanese model of

TABLE 4

Capital Inflows[a] as Shares of Gross Domestic Investment, 1970-80

Country group	1970	1977	1978	1979	1980
			(percent)		
Low income countries	4	7	6	10	8
Asia	3	4	4	7	5
China	0	0	1	5	1
India	7	5	4	4	7
Africa, South of Sahara	29	40	43	52	59
Middle income countries	15	18	18	17	15
East Asia & Pacific	19	16	14	14	15
Middle East & North Africa	17	21	16	14	10
Africa, South of Sahara[b]	16	13	20	22	17
Southern Europe	12	17	19	22	22
Latin America & Caribbean	13	18	21	21	17
Middle income oil importers	15	17	19	20	18
Middle income oil exporters	13	18	16	15	11
All low and middle income developing countries	**11**	**15**	**15**	**16**	**13**

[a] Official transfers, net direct foreign investment, and net medium and long term borrowing.

[b] Excludes South Africa although it is included in all sub-totals and totals.

Source: World Bank: Debtor Reporting System for net medium and long term borrowing; "World Development Indicators," in *World Development Report, 1983*, and data files for gross domestic investment. International Monetary Fund, *International Financial Statistics*, various issues, for net direct foreign investment and official transfers.

development. Their economies have been more open than Japan's in many respects. They have compressed development into a shorter period than Japan did. The political weakness of some of the East Asian countries during the 1950s and 1960s precluded the confrontational posture vis-à-vis the industrial countries that was popular in Latin America and South Asia in the 1950s. But the Southeast Asian countries used their political strength through the Association of Southeast Asian Nations much more productively than the Latin American and Middle Eastern countries. While immigrant communities — the 'overseas' Chinese and Indians — played an important role, notably in providing an international network that facilitated trade, economic performance did not follow their weight in the population.

The only hypothesis that explains why some developing countries have grown rapidly, while others have not, links the adoption of a positive development philosophy with a policy framework that leads through market mechanisms to efficient resource allocation and utilization.[30] Such policies are reflected in high savings, investment, and productivity (Tables 3, 4 and 5) and low rates of inflation (Table 6) as well as high growth.

Economic policies and development

The countries that grew rapidly recognized, while other developing countries did not, that uncertainty is the normal, pervasive state of the economic environment as it is of the whole human condition. It is the reality which faces individuals, enterprises and governments. Economic policies, therefore, have to ensure that economic units are flexible so that they can handle uncertainty. Because uncertainty entails risks, individuals have to be encouraged to take initiatives. This means that, subject to appropriate taxation, workers, managers, savers and investors have to be stimulated to be productive by wages, salaries and profits linked to the risks they take and the efforts they make. Decentralizing decision-making through market mechanisms offsets mistakes whereas a centrally planned system tends to multiply them.

Governments have an essential role to play in establishing social and political cohesiveness and the rule of law. They must also provide a sense of direction, building a social consensus around growth objectives and the policies necessary to implement them.[31] Despite the prevalence of uncertainty, individuals and enterprises have to explore options for the future. Governments have to choose carefully among investment and policy options because resources are scarce, lead times can be long and they must avoid introducing additional uncertainty into the system by frequent policy changes. Scenarios of possible future outcomes can be

useful in testing trade-offs between alternative options. Major projects with considerable externalities can be ranked by their likely socio-economic returns. But drawing up detailed plans is generally a waste of resources. Singapore, for example, stopped its detailed annual planning because the planning mechanisms could not keep up with the economy's growth.

The basic policy framework —

Economic and social policies form a framework that affects all aspects of economic behavior. Even such essentially cultural policies as those affecting education will affect both production and distribution. To be effective policies must therefore be mutually consistent. The key economic policies are monetary, financial and associated exchange rate policies, which determine the financial parameters within which an economy operates; trade (affecting exchange rate) policies, which largely determine the efficiency and competitivenes with which tradeable (and many associated non-tradeable) goods and services are produced and which therefore also determine foreign exchange earnings and the ability to borrow abroad; fiscal policies which determine the resources a country will have for investment in the social and physical infrastructure and for welfare purposes, and how efficiently such resources are used; and manpower and labor policies which determine the real cost and remuneration of labor. Together these policies determine relative prices within an economy and the overall course of prices over time. Education, health and other welfare policies determine the composition, skill, organization, and productivity of the workforce and how income is distributed.

— *Sectoral policies*

The East and Southeast Asian experience suggests that if the basic policy framework is appropriate, only limited sectoral policies are required to stimulate areas of actual and potential comparative advantage. Special initiatives can then be successful in stimulating promising activities without introducing costly distortions. For example, Singapore was active in starting ship repair as an adjunct to entrepôt activities. This led to oil rig construction, maintenance, and servicing in nearby seas, and oil rig expertise led to the development of heavy barges now widely used beyond Singapore's neighborhood. But if a wide range of activities is stimulated by protection or other incentives, in effect nothing is protected while distortions make it difficult to know which activities are economic. Measures such as production licensing, import and export quotas encourage 'rent seeking'.[32] That is, entrepreneurs seek such privileges because of the profitable monopoly powers which they confer. They

TABLE 5
Growth of GDP per Unit of Labor Force, 1960-80

Country group	Average annual real growth rate 1960-70 (percent)	1970-80 (percent)
Low income Asia	3.1	2.3
Low income Africa, South of Sahara	1.6	−0.5
Middle income countries	4.1	3.1
East Asia & Pacific	4.6	5.3
Middle East & North Africa	5.9	1.5
Africa, South of Sahara	2.1	1.8
Southern Europe	5.5	3.8
Latin America & Caribbean	3.2	3.2
Middle income oil importers	3.7	3.4
Middle income oil exporters	4.5	2.7

Source: World Bank, *World Tables: The Third Edition* (Baltimore and London: published for the World Bank by the Johns Hopkins University Press, forthcoming).

TABLE 6
Consumer Price Indices for Selected Countries

Country	Consumer Price Indices 1970	1980	1981	1982	1983
	(period average, 1980 = 100)				
Indonesia	20.0	100.0	112.2	122.9	137.4
Korea, Republic of	22.2	100.0	121.3	130.1	134.5
Malaysia	56.4	100.0	109.7	116.1	120.4
Philippines	28.4	100.0	114.6	126.0	139.0
Singapore	53.5	100.0	108.3	112.4	113.8
Thailand	39.5	100.0	112.7	118.6	123.0
Argentina	0.0	100.0	204.5	541.4	2,402.9
Brazil	4.9	100.0	205.6	407.0	984.9
Chile	n.a.	100.0	119.7	131.6	167.4
Ghana	3.4	100.0	216.5	264.8	590.1
Israel	3.1	100.0	216.8	477.8	1,173.5
Turkey	5.6	100.0	137.6	182.6	235.2

Source: International Monetary Fund, *International Financial Statistics Yearbook*, 1984.

neglect production and sales problems, and crowd into capital cities where access to the government officials who give away privileges through regulation is best. Power passes from legislators to administrators, often at a quite low level, and introduces new elements of uncertainty into the economic environment. Bureaucrats may be better judges of the public interest than entrepreneurs, but they are usually worse forecasters of economic trends in particular industries. Even in the rapidly-growing countries government officials have picked more losers than winners when they have attempted to intervene across a broad range of activities. It has been more common for the winners to pick the governments than vice versa.

— *political obstacles*

There is no simple recipe for getting economic policies 'right'. A government does not inherit a clear chess board. Policies — appropriate and inappropriate — are already in place and are protected by vested interests. Those who will gain from change are usually weak and ill organized. Those who benefit from the status quo are well entrenched. The more distorted policies are and the longer they have been in place, the harder it is to make changes. In spite of the rhetoric, 'structural adjustment' in the 1970s has been very limited because moving toward improved policies is very difficult. There is no single optimal way of doing so. Putting workers and entrepreneurs on notice of impending changes and introducing these changes gradually over three to five years works in some countries. In others it is best to impose changes by fiat overnight. If the political obstacles to change can be overcome, it is likely that resources will flow to areas in which a country has the greatest comparative advantage, and that new areas of comparative advantage will be created with appropriate policies. In the short-run, some imbalance among sectors may give a fillip as bottlenecks are broken, but overall inter- and intra-sectoral balance is essential, with resources going to the most productive margins to start new activities. The economy will grow faster, productive employment opportunities will be created, and standards of living will rise. Further changes will be easier to make. There is thus a presumption that rapid adjustment — provided the new policies are appropriate — will be less costly than slow adjustment, but politically it is rarely possible. For Taiwan and particularly for Korea, liberalization has been, and is, a long, slow process. Development has been much easier for countries such as Malaysia and Thailand that never had highly-regulated economies. The timing and progression of liberalization in some Latin American countries, in contrast, exacerbated the problems of the recent 'stop' episode.

— *capital inflows*

The extent of reliance on foreign capital and the efficiency of its utilization is largely determined by domestic policy. Aid flows and borrowing abroad can ease the development process, but countries with poor policies borrow excessively and invest the proceeds in 'white elephants' or spend them on consumption. Thus, capital inflows have been a relatively low share of East and Southeast Asian investment in the 1970s (Table 4). The Philippines was an exception, borrowing heavily in commercial markets, investing poorly and spending the proceeds on consumption; whereas counries like Korea and Thailand experienced relatively mild 'liquidity' problems, in the Philippines solvency was at stake.[33]

— *public ownership*

A fundamental conflict between the need for risk-taking and conservative public management makes the public ownership of economic activities, particularly such entrepreneurial activities as farming and manufacturing, very difficult. Public enterprise managers should be risk-takers as entrepreneurs but they must be risk-averters if they are to fulfill their public service responsibilities. Collectively-managed enterprises also find it difficult to take the risks necessary to run an effective business. Risk-taking entails some failure, and state or collectively-owned enterprises can rarely be permitted to fail. The management of public enterprises, particularly those in production or service activities beset by uncertainty, is thus inherently difficult. Efficient public enterprises are generally limited to areas with relatively stable supply and demand conditions. For example, it is much easier to predict the future demand for sewage lines or schools than that for different styles of shoes. Political influence, poorly-trained staff and overstaffing are additional problems of many public enterprises, but even if these are overcome the management of public enterprises remains difficult. There are some examples of successful public enterprises in developing countries, but they are few. The move away from public ownership in agriculture and industry in the rapidly growing countries since the 1960s has contributed greatly to productivity and to the ability to keep government budgets under control. Countries such as Tanzania, on the other hand, indicate the problems that arise in heavily public-enterprise-oriented economies.

An emphasis on equity has played a role in rapid growth through the creation of opportunities for employment in the formal and informal sectors. (In contrast, premature increases in wages through the adoption of well-meant industrial society standards of working hours and fringe

benefits raise costs of production and limit employment, slowing growth and income redistribution). Mass access to education is important. Other ways of improving living standards and economic efficiency have taken the form of expanding such public goods as transportation at the expense of the growth of private vehicles in Taiwan and Korea, and providing housing for lower income groups cost effectively either through public or private sectors.

— *and exports*

Some accounts of the rapid growth of East and Southeast Asian countries attribute it to land reform and to the expansion of exports of labor-intensive manufacturers. These are gross oversimplifications. Land reform did not lead to increasing rural incomes in Korea until the terms-of-trade bias against agriculture was removed. It is true that these countries' comparative-advantage-oriented policies led to a rapid expansion of labor-intensive exports. Taking advantage of specialization through trade and overcoming balance-of-payments constraints were important to their growth, demonstrating, incidentally, that accounts of the new protectionism have been greatly exaggerated.[34] However, their overall policy framework was the critical factor in growth, and high export growth was merely one manifestation of that policy framework. In different countries and at different times, the same policies would have led to different export mixes and to different export/GDP ratios. Where other policies were inappropriate, for example, where inflation continued to be high, removing protection did not lead to sustained growth. Korea's excessive emphasis on government control, capital-intensive production, with ensuing skilled-labor bottlenecks, inflation, and exchange-rate difficulties, and its failure to liberalize its trade and financial policies, made for difficulties at home and heavy borrowing aboard at the end of the 1970s and the beginning of the 1980s.

Conclusions

As countries overcome their human-resource constraints they can adopt policies that will replicate the East and Southeast Asian high growth experience. The opportunities for catching up the industrial countries by using existing 'technology' both in the sense of economic management and production techniques make it possible to achieve real growth rates of 7 per cent or more over the long run. The policies in place in most countries, however, are not supportive of such 'catching up'. The 'dependencia' ideology reinforced by structural and development economics views has left a legacy of economic distortions which have

seriously weakened many economies. In extreme cases, such distortions have led to economic crisis and political chaos. Changing such policies takes major efforts and a considerable time. More rapid and sustained growth cannot be accomplished without profound ideological changes in countries lagging behind. Relatively buoyant international conditions make change easier, so that countries taking advantage of the current recovery will benefit. But waiting for a suitable international environment only entrenches inappropriate policies more deeply, making them more difficult to change. Though developing countries, like the industrial ones, have a growing responsibility for the establishment and maintenance of international buoyancy in trade and other international flows, growth and development are essentially national problems and must be tackled at the national level.

[1] D. Morawetz, *Twenty-Five Years of Economic Development*, Baltimore, Md: Johns Hopkins University Press, 1977.

[2] A. Maddison, Phases of Capitalist Development, *Banca Nazionale del Lavoro, Quarterly Review*, 1977.

[3] The closing of 'the gap' between the rapidly growing developing and industrial countries is even more striking when per capita income is calculated in purchasing parity terms. See Irving B. Kravis, Zoltan Kenessey, Alan Heston and Robert Summers, *A System of International Comparisons of Gross Product and Purchasing Power*, Johns Hopkins University Press, 1975, and Irving B. Kravis, Alan W. Heston and Robert Summers, Real GDP per Capita for More Than One Hundred Countries, *Economic Journal*, June, 1981.

[4] The difference between 1960s and 1970s growth rates arises in part from the way in which national product is measured at constant prices, but it also reflects real differences in growth.

[5] See 'World Development Indicators' in World Bank, *World Development Report, 1983* (Washington, D.C., 1983) for a summary of income distribution and physical indicators by country. Note that the concepts are not clear enough and the data is not robust enough to prove or disprove hypotheses about growth and income distribution. Where growth was followed by worsening income distribution as was the case in many developing countries, this was largely the result of inept economic policies which in any case, in the not too long a run, also reduced growth.

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[16] H.B. Chenery *et al.*, *Redistribution with Growth*-, London, Oxford, 1974.

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[21] G. Johnson, *Economic Policies Toward Less Developed Countries*, 1967.

[22] D. Morawetz, Employment Implications of Industrialization, A Survey, *Economic Journal*, September 1974.

[23] During 1971-81, East Asia and Latin America made the same amount of IMF purchases, with East Asia particularly active in 1980-81. However, as a share of GDP, East Asia's purchases (net of the Reserve Tranche) represented 0.25 per cent, whereas Latin America's purchases were only 0.10 per cent.

[24] A. Kreuger, *Liberalization Attempts and Consequences*, New York, NBER, 1978.

[25] B. Balassa, *The Structure of Protection in Developing Countries*, Baltimore Md., Johns Hopkins, 1971.

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[27] Simon Kuznets, 'The Economic Growth of Small Nations', in E.A.G. Robinson (ed.), *Economic Consequences of the Size of Nations*, (London: Macmillan, 1960).

[28] B. Balassa and H. Hughes, 'Statistical Indicators of Levels of Industrial Development', World Bank, May 1969.

[29] Irma Adelman and Cynthia Taft Morris, *Society, Politics and Economic Development*, rev. ed., (Johns Hopkins University Press, 1971) attempts to relate political regimes and economic performance, unfortunately not successfully.

[30] Such a hypothesis, of course, begs a further question: Why did the successful countries, particularly in East and Southeast Asia, adopt strongly development oriented policies while so many other developing countries, including some in the same region, did not?

[31] H.W. Arndt, *The Rise and Fall of Economic Growth*, Longman Cheshire Pty. Ltd., 1978, suggests that the idea of 'growth' was a factor in high economic performance in the 1950s and 1960s.

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See also, William R. Cline, 'Can the East Asian Model of Development be Generalized?', *World Development*, Vol.10, No.2 (February, 1982) presents simulations of market penetration of developed country markets by developing country exports based on a partial 1976 data base. The simulations show that with fixed coefficients, products, etc., north-south trade would be limited. But in the real world, coefficients are not fixed. If developing countries export more they will be able to import more. Intra-industry trade will grow rapidly, as it has among the industrial countries.

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